86-578

No. _____

Supreme Court, U.S.
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IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1986

LOUIS L. PHILLIPS AND
L.L. PHILLIPS CHARITIES, INC.,

Petitioners,

v.

MERRILL, LYNCH, PIERCE, FENNER & SMITH,
INC. and BEN M. SIRIANNI,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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October 7, 1986

QUESTION PRESENTED

Whether predispute arbitration agreements between customers and securities brokers/dealers may be enforced to deprive investors of a federal forum for claims arising under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240.10b-5 (1985).

LIST OF PARTIES

Parties to the proceedings below were petitioners Louis L. Phillips and L.L. Phillips Charities, Inc.,[1] and respondents Merrill Lynch, Pierce, Fenner & Smith, Inc., and Ben M. Sirianni.

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[1] Rule 28.1 List:

L.L. Phillips Charities, Inc. has no parent companies, subsidiaries or affiliates.

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LOUIS L. PHILLIPS AND
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Petitioners,

v.

MERRILL, LYNCH, PIERCE, FENNER & SMITH,
INC. and BEN M. SIRIANNI,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Petitioners Louis L. Phillips and L.L. Phillips Charities, Inc. respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit Court, entered in the above-entitled proceeding on July 9, 1986.

OPINIONS BELOW

The opinion of the Court of Appeals for the Eighth Circuit is reported at 795 F.2d 1393, and is reprinted in the appendix, p. A-1, infra.

The memorandum decision of the United State District Court for the District of Minnesota (Murphy, J.) has not been reported. It is reprinted in the appendix, p. 34, infra.

JURISDICTION

The judgment of the Court of Appeals was entered on July 9, 1986. A copy of the opinion is reproduced at Appendix, p. A-1, infra. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Arbitration Act

Section 2, 9 U.S.C. § 2
Section 3, 9. U.S.C. § 3

Securities Act of 1933 ("1933 Act")

Section 12(2), 15 U.S.C. § 77l(2)
Section 14, 15 U.S.C. § 77n

Securities Exchange Act of 1934 ("1934 Act")

Section 10(b), 15 U.S.C. § 78(b)
Section 19, 15 U.S.C. § 78(s)
Section 27, 15 U.S.C. § 78(aa);
Section 29(a), 15 U.S.C. § 78cc(a)

Securities and Exchange Commission Regulations

Rule 10b-5, 17 C.F.R. § 240.10b-5
Rule 15c2-2, 17 C.F.R. § 240.15c2-2

The text of these statutes and regulations is set forth in the appendix, p. A-39, infra.

STATEMENT OF THE CASE AND JURISDICTION BELOW

In October 1978, Louis L. Phillips opened securities accounts for himself and for L.L. Phillips Charities, Inc. with Merrill Lynch, Pierce, Fenner & Smith, Inc. The accounts were managed by Ben M. Sirianni, a vice president and registered representative of Merrill Lynch.[1] Upon opening the accounts, Phillips signed a standard "Customer Agreement" and a standard "Option Agreement", both of which provided that any controversies relating to the accounts "shall be submitted to arbitration." The full text of the arbitration clauses are set forth in the Court of Appeals opinion. 795 F.2d at 1394 n.2; App. at A-3-5.

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[1] Petitioners Louis L. Phillips and L.L. Phillips Charities, Inc. will be referred to as "Phillips" except where necessary to distinguish them. Respondents Merrill Lynch, Pierce, Fenner and Smith, Inc. and Ben M. Sirianni will be referred to as Merrill Lynch except where necessary to distinguish them.

In July 1981, Phillips sued Merrill Lynch in the federal district court in Minnesota, charging that its registered representative, Sirianni, executed unauthorized option trades in Phillips' accounts and made various misrepresentations and omissions regarding those trades. Phillips' complaint alleged violations section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. 78j(b), and Rule 10b-5, section 12(2) of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. § 77l(2)(1982), the Minnesota Securities Act, Minn. Stat. Ann. §§ 80A.01, 80A.03 (West Supp. 1986), and state common law. The district court had jurisdiction under section 22(a) of the 1933 Act and section 27 of the 1934 Act. 15 U.S.C. §§ 77v(a) and 78aa.

On March 27, 1985, Merrill Lynch moved, pursuant to the parties' arbitration agreement, to compel

arbitration of the Phillips' claims arising under section 10(b) of the 1934 Act and Rule 10b-5. The district court denied this motion and on May 9, 1985 Merrill Lynch appealed to the Court of Appeals for the Eighth Circuit. The Eighth Circuit Court of Appeals invoked jurisdiction under 28 U.S.C. § 1292(a)(1) (1982). 795 F.2d. at 1395 n.4; App. at p. A-7.

A split panel of the Eighth Circuit reversed the district court. It ruled that the Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1982), required enforcement of the arbitration agreement, and that section 29(a) of the 1934 Act, 15 U.S.C. § 78cc(a) (1982), does not create an exception to the arbitration requirement.

The Eighth Circuit acknowledged that its ruling conflicted with the decisions of eight other circuit courts of appeals. Id. 795 F.2d. at 1396, 1400; App. at A-

11-13, 30. It also rejected the Phillips argument that Securities and Exchange Commission ("SEC") regulation 15c2-2, 17 C.F.R. § 240.15c 2-2 (1985), bars enforcement of the arbitration agreement, and concluded that "the SEC was mistaken" in its interpretation of federal law. Id. 795 F.2d at 1398 n.17; App. at A-23-24.

REASONS THE WRIT SHOULD BE GRANTED

I. This Court Should Grant Certiorari to Resolve the Conflict Among the Circuits Created by the Eighth Circuit When it Ruled that Predispute Arbitration Agreements May be Enforced to Deprive Investors of a Federal Forum for Claims Arising Under Section 10(b) of the 1934 Act and Rule 10(b)-5. 15 U.S.C. 78(b) (1982); 17 C.F.R. § 240.10b-5 (1985).

A split panel of the Eighth Circuit stands alone and in direct conflict with eight other circuits in holding that a securities dealer may enforce a predispute arbitration agreement to deprive a customer of a federal court forum for claims arising under section 10(b) of the 1934 Act and Rule 10b-5.[2] The Eighth

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[2] The Second, Third, Fifth, Sixth, Seventh, Ninth, Tenth and Eleventh Circuits have rejected the Eighth Circuit's view. See, Wolfe v. E.F. Hutton & Company, Lexis Database (11th Cir. September 29, 1986); Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 797 F.2d 1197 (3rd Cir. 1986); Conover v. Dean Witter Reynolds, Inc., 797 F.2d 520 (9th Cir. 1986); Miller v. Drexel Burnham Lambert, Inc., 791 F.2d 850 (11th Cir. 1986)(per curiam); King v. Drexel Burnham Lambert, Inc., 796 F.2d 59 (5th Cir.

Circuit acknowledged that its ruling creates a direct conflict within the circuits:

> Because we are not bound by the precedents of other circuits, we are free to make a new assessment of this issue. We have made that assessment, and now create a conflict within the circuits.

795 F.2d at 1400. App. at A-30. The Eighth Circuit then invited Supreme Court review of its ruling on this important issue:

1986); McMahon v. Shearson/American Express, Inc., 788 F.2d 94, (2d Cir. 1986) cert. granted, ____ U.S. ____ (October 6, 1986); Belke v. Merrill Lynch, Pierce, Fenner & Smith, 693 F.2d 1023, 1025-26 (11th Cir. 1982); Sawyer v. Raymond, James & Associates, Inc., 642 F.2d 791, 792 (5th Cir. 1981); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1030 (6th Cir. 1979); Merrill Lynch, Pierce Fenner & Smith, Inc. v. Moore, 590 F.2d 823, 827-29 (10th Cir. 1978); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 833-36 (7th Cir. 1977); Allegaert v. Perot, 548 F.2d 432, 437-38 (2d Cir.), cert. denied, 432 U.S. 910 (1977); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 536-37 (3d Cir.), cert. denied, 429 U.S. 1010 (1976).

> We assume the Supreme Court will eventually decide this question.

Id. App. at A-30.

All other circuits hold that a securities dealer cannot deprive a customer of access to the federal courts for section 10(b) and Rule 10b-5 claims by enforcing a predispute arbitration agreement.

The District Courts and Courts of Appeals need guidance now. "[T]here has been considerable ferment in the federal district courts regarding the arbitrability of claims arising under section 10(b) and Rule 10b-5." Phillips v. Merrill Lynch, 795 F.2d 1393, 1396 n.8 (8th Cir. 1986). App. at A-13. At least 118 district courts have addressed the enforceability of agreements to arbitrate section 10(b) since this Court's decision in Dean Witter Reynolds, Inc. v. Byrd, 470

U.S. 213 (1985).[3] The Eighth Circuit's open split with the other circuits will exacerbate the "ferment in the district courts" in the few circuits that have not squarely addressed the issue.

This issue is of tremendous importance to the investing public, the securities industry, and the SEC. Mandatory arbitration clauses are now standard in customer agreements in the securities industry nationwide. The role of the federal judiciary in the enforcement of federal securities laws is at stake. Judge Adams of the Third Circuit also urges prompt Supreme Court review of this issue:

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[3] See, Petition for Writ of Certiorari, Shearson/American Express, Inc. v. McMahon, S.Ct. Docket 86-44, Appendix F. Stating also, at n.1, that 76 decisions (64%) have held § 10(b) claims must be arbitrated, 42 decisions (36%) have held that § 10(b) claims may not be arbitrated. One case was stayed pending outcome of this case. The Supreme Court granted certiorari in McMahon on October 6, 1986.

> . . . some uncertainly necessarily will remain until the Supreme Court speaks authoritatively to this issue. Since commercial relations affecting thousands of investors and scores of brokerage houses will remain in the shadow of doubt until then, an early definitive decision by the Supreme Court would be a helpful development.

Jacobson, supra, 749 F.2d at 1206 (Adams, J., concurring in part and dissenting in part).

Until this issue is resolved by the Supreme Court, parties will continue to clog the courts with motions raising this issue.[4] In the Eighth Circuit, until this issue is decided, deserving parties will be deprived of access to the federal

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[4] Motions to compel arbitration will continue even in circuits where such agreements are presently not enforceable to avoid claims of waiver. See e.g., Price v. Drexel Burnham Lambert, Inc., 791 F.2d 1156 (5th Cir. 1986)(failure to move for arbitration waived right to arbitration). In the Eighth Circuit parties will still file in federal court to preserve their rights to a federal forum and to avoid the waiver argument.

courts for their section 10(b) and Rule 10b-5 claims.

Moreover, the conflict among the circuits will inevitably lead to forum shopping by litigants. Most brokerage houses that are parties in section 10(b) litigation have offices in cities nationwide. In this case, for example, petitioner Louis L. Phillips is a resident of Wisconsin. Petitioner's claims could have been filed in district court in Wisconsin where the arbitration agreements would not be enforceable under the Seventh Circuit's decision in Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 833-36 (7th Cir. 1977). The Phillips' claims could also have been brought in New York, where Merrill Lynch has its headquarters. The arbitration provisions would not have been enforceable in New York under the Second Circuit's decision in McMahon v. Shearson/American

Express, Inc., 788 F.2d 94 (2d cir. 1986) cert. granted, ____ U.S. ____ (October 6, 1986).

The significance of this issue is confirmed by this Court's recent grant of certiorari in McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (2d Cir. 1986), cert granted, ____U.S. _____ (October 6, 1986). The Eighth Circuit expressly rejected McMahon's ruling that the similarity of the Securities Act of 1933 and the Exchange Act of 1934, public policy considerations, and the legislative history of the federal securities laws "support the compelling need for a judicial forum in the resolution of securities law disputes." 788 F.2d at 98.

This Court granted certiorari on the Second Circuit's decision in McMahon. It is logical to grant certiorari in this case as well. McMahon and Phillips present diametrically opposed rulings on

an important issue of federal securities law. The Court should review both decisions at the same time.

A. The Eighth Circuit Decision Also Endorses Arbitration Agreements that the SEC Prohibits by Rule 15c2-2, 17 C.F.R. § 240.15c2-2.

The Securities and Exchange Commission has condemned the type of arbitration agreement that the Eighth Circuit enforced in this case. Relying on the consistent holdings of the federal courts, the SEC promulgated Rule 15c2-2 in November of 1983. 17 C.F.R. § 240.15c2-2. That regulation prohibits the use of the very type of arbitration agreement the Eighth Circuit approved in this case. 17 C.F.R. § 15c2-2 states:

> (a) It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the Federal securities

> laws, or to have in effect such an agreement, pursuant to which it effects transactions with for customer.

The Eighth Circuit dismissed the SEC regulation by concluding that "the SEC was mistaken." Phillips, 795 F.2d at 1398 n. 17; App. at A-24. The opinion of federal regulators cannot be disregarded. This court should confirm the vitality of SEC regulations designed to protect the investing public, and which outlaw the very provisions the Court below endorsed.

The Court of Appeals' ruling below conflicts with the rulings of eight circuit Court of Appeals and conflicts with the SEC regulations that declare predispute arbitration agreements unlawful. These conflicts should be resolved now.

II. The Eighth Circuit's Ruling Is Contrary to Law and Does Not Reflect Congress' Intent that Investors Have a Federal Judicial Forum for Section 10(b) and Rule 10b-5 Claims.

This Court first considered the arbitrability of federal securities law claims more than 30 years ago in Wilko v. Swan, 346 U.S. 427 (1953). In Wilko this Court held that claims arising under section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77l(2), are not subject to arbitration under predispute agreements otherwise enforceable under the United States Arbitration Act, 9 U.S.C. §§ 1-14. Wilko held that the right to a judicial forum was a provision of the 1933 Act and, thus, subject to § 14 of the 1933 Act, 15 U.S.C. § 77n (1982), which voids any stipulation waiving compliance with any provision of that Act. Wilko, 346 U.S. at 434-35.

The lower federal courts uniformly extended Wilko to claims arising under

section 10(b) and Rule 10b-5, and ruled that agreements to arbitrate such claims were unenforceable. Dean Witter Reynolds v. Byrd, 470 U.S. 213, 215 n.1 (1985), did not change the law established by the circuits since Wilko was issued in 1953. The Court in Byrd expressly declined to rule on the arbitrability of section 10(b) and Rule 10b-5 claims. The Court summarized its review of this issue, noting that in Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974), it questioned the applicability of Wilko to section 10(b) claims, but concluded:

> The Court did not, however, hold that Wilko would not apply in the context of a § 10(b) or Rule 10b-5 claim, and Wilko has retained considerable vitality in the lower federal courts. Indeed, numerous District Courts and Courts of Appeal have held that the Wilko analysis applies to claims arising under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78(b), and that the agreements to arbitrate such claims are therefore

unenforceable. Byrd, 105 S.Ct. 1240, Note 1.

470 U.S. 215-16 n.1

Scherk carved out the extremely "narrow exception to Wilko for cases concerning international securities transactions." Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1030 (6th Cir. 1979). See also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., ____ U.S. _____, 105 S.Ct. 3346 (1985). It is logical to enforce arbitration agreements where parties, faced with unique intricacies of foreign law and the special problems of international transactions, elect to arbitrate. International complexities do not apply to this case.

Justice White's concurring opinion in Byrd also notes that the arbitrability of section 10(b) and Rule 10b-5 was not then before the Court. 470 U.S. at 724. In dicta, Justice White suggests Wilko may

not apply to a section 10(b) claim because its existence is implied from the 1934 Act, and not expressly set forth as is a section 12(2) claim under the 1933 Act. Justice White also commented that since 10b-5 was implied and hence not literally a "provision of this chapter," the prohibition in the 1934 Act against "waiv[ing] compliance with any provisions of this chapter" might not be applicable.[5]

The Eighth Circuit incorrectly viewed Byrd as an invitation to discard over 30 years of law holding that section 10(b) and Rule 10b-5 claims are the exclusive province of the federal courts.[6] The Eighth Circuit was wrong.

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[5] The same provision also prohibits waiver of compliance with "any rule or regulation" promulgated under the Act. 15 U.S.C. § 78 cc(a).

[6] Until the ruling in this case, the Eighth Circuit appeared to agree with the unanimous rulings of the other circuits. See, Surman v. Merrill Lynch, 733 F.2d 59, 61-62 (8th Cir. 1984).

The 1934 Act, like the 1933 Act, is designed to protect investors. Section 10(b) of the 1934 Act should be treated the same as section 12(2) of the 1933 Act with respect to arbitration. Both sections 12(2) of the 1933 Act and Rule 10b-5 create a special right to recover for misrepresentation, a right which differs substantially from the common-law. Wilko v. Swan, 346 U.S. at 431. In defining section 12(2) to create a "special right" the Court noted that under section 12(2) the defendant has the burden of proving lack of scienter. Id. Section 10(b) and Rule 10b-5 claims also involve scienter. The only difference is the plaintiff has the burden to prove scienter in a section 10(b) and Rule 10b-5 case. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 190 (1976). A difference in the allocation of the burden of proof cannot

justify different arbitration rules for section 10(b) and Rule 10b-5 claims.

The SEC arbitration regulation, 17 C.F.R. § 15c2-2, makes no distinction between the 1933 Act claims and 1934 Act claims. The SEC responded to those who urged a distinction as follows: "these commentators have cited no basis upon which the Commission can determine that the Wilko analysis does not hold equally true for other federal securities acts which contain substantially identical anti-waiver provisions." See Exchange Act Release No. 20397, CCH Fed. Sec. L.Rep. ¶ 83,452, 48 F.R. 53404 at n.6.

Whether an injured investor will have a right to judicial resolution of a federal securities claim should not depend on whether the claim is one expressly provided, as opposed to one implied by Congress. The Supreme Court has consistently held that section 27 of the

the 1934 Act, 15 U.S.C. § 78aa, extends exclusive jurisdiction to the federal courts over any action to enforce any duty created by the Act, including implied causes of action. See J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964). Section 12(2) claims are express while section 10b-5 are implied, but that difference has no legal significance on the arbitrability issue.

In Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520 (9th Cir. 1986) filed several days after the Court of Appeals' decision in this case, the Ninth Circuit ruled that predispute arbitration agreements cannot be enforced to deprive an investor of access to the federal courts for section 10(b) and Rule 10b-5 claims.

* * *

> [T]he language and history of the securities statutes, considered against the background of controlling Supreme Court decisions and

> circuit court decisions stressing the importance of a federal judicial forum for Rule 10b-5 claims, require us to hold that the judicial forum for such claims cannot be waived by an arbitration agreement between a customer and broker.

794 F.2d at 521.

All Courts of Appeal addressing this issue since Byrd, except Phillips, have held that predispute agreements to arbitrate section 10(b) claims are unenforceable.[7]

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[7] King and Conover are also now before this Court on Petition for Writ of Certiorari, raising this same issue. Drexel Burnham Lambert, Inc. v. King, Dkt. No. 86-282; Conover v. Dean Witter Reynolds, Inc., Dkt. No. 86-___. This issue is also before this Court on Petition for Writ of Certiorari from an unreported summary affirmance by the Second Circuit in Kidder, Peabody & Co., Inc. v. Intre Sport, Ltd., Dkt. No. 86-40.

A. The 1975 Amendments to the Federal Securities Laws Confirm that Predispute Agreements to Arbitrate Claims Arising Under § 10(b) of the 1934 Act are not Enforceable.

Congress rejected the notion that predispute arbitration agreements between customers and securities dealers are enforceable when it enacted major amendments to the federal securities laws in 1975. Those 1975 amendments were the "most substantial and significant revision of this country's federal securities laws since the passage of the Securities Exchange Act of 1934." Securities Acts Amendments of 1975: Hearings on S. 249 before Subcomm. on the Securities of the Senate Commission on Banking, Housing and Urban Affairs, 94th Congress, First Session. 1 (1975).

As part of that revision, Congress enacted 15 U.S.C. § 78bb(b), which permits compulsory arbitration of securities

claims between securities professionals only. Congress chose not to permit compulsory arbitration in disputes between customers and securities dealers. The Conference Report accompanying the legislation stated that: "[i]t was the clear understanding of the conferees that this amendment did not change existing law, as articulated in Wilko v. Swan, 346 U.S. 427, (1953), concerning the effect of arbitration proceeding provisions and agreements entered into by [other] persons dealing with members and participants of self-regulatory organizations. H.R. Rep. No. 229, 94th Cong. 1 Sess. 91, 111 (1975), reprinted in 1975 U.S. Code Cong. & Ad. News at 179, 321.

Congress enacted a specific provision to permit arbitration between securities professionals. Its refusal to authorize compulsory arbitration for section 10(b) and Rule 10b-5 claims by customers against

dealers confirms that it intended that these important components of the securities laws be enforced by the federal courts.

III. The Question of Whether Predispute Arbitration Agreements May be Enforced to Deprive an Investor of a Federal Forum Is Important to the Investing Public, the Securities Industry and the SEC and Should Be Decided by this Court.

This Court has twice declined to decide whether predispute agreements may be enforced to deprive customers of their right to a federal forum for section 10(b) and Rule 10b-5 claims. Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 215-16 n.1, (1985); Scherk v. Alberto-Culver Company, 417 U.S. 506, 514-15 n.8, (1974). In both cases the issue was not properly before the Court. That issue is before this Court now.

A. The Supreme Court Should Resolve this Issue Because Injured Investors Have Lost Substantial Rights in the Eighth Circuit.

Injured investors are being treated differently in the Eighth Circuit than in the other eight circuits that have ruled. In the Eighth Circuit, investors have lost the right to judicial resolution of their section 10(b) and Rule 10b-5 claims, and are relegated to arbitration procedures which courts historically have viewed with skepticism. Not only are procedures different in the Eighth Circuit, but results on the merits of section 10(b) and Rule 10b-5 claims will be different if arbitration is required. As the Court declared in Bernhardt v. Polygraphic Co. of America, Inc., 350 U.S. 198, 203 (1956):

> The nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action. The change from a court of law to an arbitration panel may make a

> radical difference in ultimate result.

350 U.S. at 203.

The enforcement of the federal securities laws is now hindered by uncertainty as to the enforceability of predispute agreements to arbitrate section 10(b) claims. Brokerage firms nationwide ask or require investors to waive, in advance of any dispute, the right to pursue in the judicial forum, all claims including Exchange Act claims.[8]

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[8] The prevalence of these uniform, arbitration agreements is confirmed by the arbitration agreements at issue in the petitions for certiorari in Shearson/American Express, Inc. v. McMahon, Dkt. No. 86-44; Drexel Burnham Lambert, Inc. v. King, Dkt. No. 86-282; Conover v. Dean Witter Reynolds, Inc., Dkt. No. 86-___; and Kidder, Peabody & Co., Inc. v. Intre Sport, Ltd., Dkt. No. 86-40, together with the arbitration agreement of Merrill Lynch, Pierce, Fenner & Smith, Inc. at issue here. See also, arbitration clauses in customer agreements cited in district court decisions involving the issue of the enforceability of predispute arbitration agreements in the context of Exchange Act claims, Appendix F to the Petition for Certiorari, Shearson/American Express, Inc. v.

Securities dealers should not be able to shield unlawful conduct from scrutiny by the federal courts through arbitration agreements. Public policy will best be served if investor grievances are aired in the courtroom where full discovery and the strength of the judiciary may be brought into play.

B. The Federal Courts Cannot Abandon their Role as Guardians of the Investor Protection Provided by Section 10(b) and Rule 10b-5.

Enforcement of the Securities Act of 1934 will be relegated to an anonymous group of arbitrators unless the Court of Appeals decision in this case is reversed. The Phillips' section 10(b) and Rule 10b-5 claims involve subjective findings on the purpose and knowledge of Merrill Lynch in handling the account. This Court has ruled that questions of this sort should

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McMahon, S.Ct. Dkt. No. 86-44.

be handled by the federal courts, and not by arbitrators. As the court announced in Wilko v. Swan, 346 U.S. 427 (1953):

> This case requires subjective findings on the purpose and knowledge of an alleged violator of the Act. They must be not only determined but applied by the arbitrators without judicial instruction on the law. As their award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as "burden of proof," "reasonable care" or "material fact," see, note 1, supra, cannot be examined. Power to vacate an award is limited.

346 U.S. at 435-36.

Congress has committed the resolution of claims arising under the 1934 Act and regulations to the exclusive jurisdiction of the federal courts. Section 27 of the 1934 Act, 15 U.S.C. § 78aa. Congress committed section 10(b) and Rule 10b-5 claims to the exclusive jurisdiction of the federal courts because it intended

that the judiciary play an important role in enforcing these securities laws. That role cannot be abandoned to arbitrators whose decisions will often be unreviewable by the very courts to whom Congress has granted exclusive jurisdiction.

CONCLUSION

This court now has the opportunity to resolve a clearly defined legal issue of great importance to the investing public, the securities industry, the Securities and Exchange Commission, and the lower federal courts. The question presented by this petition has been fully explored by the lower courts. A conflict among the circuits has matured to the point that a resolution by this Court is not merely desirable, but is of tremendous legal

significance to litigants throughout the system.

October 7, 1986

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APPENDIX A

United States Court of Appeals
For The Eighth Circuit

No. 85-5156

Louis L. Phillips and L.L. Phillips Charities, Inc.,	*	
Appellees,	*	Appeal from the United States District Court for the District of Minnesota.
v.	*	
Merrill Lynch, Pierce, Fenner & Smith, Inc., and Ben M. Sirianni,	*	
Appellants.	*	

Submitted: December 11, 1985
Filed: July 9, 1986

Before ROSS, Circuit Judge, BRIGHT, Senior Circuit Judge, and BOWMAN, Circuit Judge.

BRIGHT, Senior Circuit Judge.

Merrill Lynch, Pierce, Fenner & Smith, Inc. and Ben M. Sirianni appeal from a district court order denying their motion to compel arbitration of claims

arising under section 10(b) of the Securities Exchange Act of 1934 (1934 Act), 15 U.S.C. § 78j(b) (1982), and Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240.10b-5 (1985). For the reasons discussed below, we reverse the order of the district court and remand for further proceedings.

I. BACKGROUND.

Louis L. Phillips opened securities accounts for himself and for L.L. Phillips Charities, Inc. with Merrill Lynch, Pierce, Fenner & Smith, Inc. in October 1978. The accounts were managed by Ben M. Sirianni, a vice president and registered representative of Merrill Lynch.[1] Upon

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[1] For the sake of simplicity, the defendants-appellants, Merrill Lynch, Pierce, Fenner & Smith, Inc. and Ben M. Sirianni, will hereinafter be referred to as "Merrill Lynch" except were it is necessary to distinguish them. Similarly,

opening of the accounts, Phillips signed a standard "Customer Agreement" and a standard "Option Agreement", both of which provided that any controversies relating to the account "shall be submitted to arbitration".[2]

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the plaintiffs-appellees, Louis L. Phillips and L.L. Phillips Charities, Inc., will be referred to as "Phillips" subject to the same qualification.

[2] Paragraph 11 of the Customer Agreement provides as follows:

> It is agreed that any controversy between us arising out of your business or this agreement, shall be submitted to arbitration conducted under the provisions of the Constitution and Rules of the Board of Governors of the New York Stock Exchange, Inc. or pursuant to the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., as the undersigned may elect. If, the controversy involves any security or commodity transaction or contract related thereto executed on an exchange located outside the United States, then such controversy shall, at the election of the undersigned, be submitted to arbitration conducted under the constitution of such exchange or under the provisions of the

In July 1981, Phillips sued Merrill Lynch, charging that its registered representative, Sirianni, executed unauthorized option trades in Phillips'

Constitution and Rules of the Board of Governors of the New York State Stock Exchange, Inc. or the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc. Arbitration must be commenced by service upon the other of a written demand for arbitration or a written notice of intention to arbitrate, therein electing the arbitration tribunal. In the event the undersigned does not make such designation within five (5) days of such demand or notice, then the undersigned authorize(s) you to do so on behalf of the undersigned.

Paragraph 9 of the Option Agreement provides as follows:

> Any controversy between us arising out of such option transactions or this agreement shall be settled by arbitration before the National Association of Securities Dealers Incorporated or the New York Stock Exchange or an Exchange located in the United States upon which listed option(s) transactions are executed only. I shall have the right of election as to which of the foregoing tribunals shall conduct the

accounts and made various misrepresentations and omissions regarding those trades. Phillips' complaint alleged violations of section 10(b) of the 1934 Act and Rule 10b-5, section 12(2) of the Securities Act of 1933 (1933 Act), 15 U.S.C. § 771(2) (1982), the Minnesota Securities Act, Minn. Stat. Ann. §§ 80A.01, 80A.03 (West Supp. 1986), and state common law.

On March 27, 1985, Merrill Lynch moved, pursuant to the parties' arbitration agreement, to compel

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arbitration. Such election is to be by registered mail addressed to Merrill Lynch's head office at 165 Broadway, New York, NY 10006, attention of the Law Department. The notice of election is to be postmarked within five days after the date of your demand to make such election. At the expiration of the five days I hereby authorize Merrill Lynch to make such election on my behalf.

arbitration of Phillips' claims arising under section 10(b) of the 1934 Act and Rule 10b-5. The district court denied this motion[3] and on May 9, 1985, Merrill

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[3] Previously, the district court had granted Merrill Lynch's motion to compel arbitration of Phillips' state securities law and state common law claims. These claims were tried before an arbitration panel of the National Association of Securities Dealers, Inc. (NASD). On July 2, 1985, after the present appeal was taken, the NASD arbitration panel issued its award, finding Merrill Lynch liable to Louis L. Phillips in the amount of $930,000 and to L.L. Phillips Charities, Inc. in the amount of $196,700. On July 9, 1985, Phillips filed a motion to confirm the arbitration award and a supplemental motion for prejudgment interest. Merrill Lynch filed a cross-motion for an order vacating, modifying, or remanding the arbitration award. On September 19, 1985, the district court denied Merrill Lynch's motion, granted Phillips' motion confirming the arbitration award, and entered judgment in Phillips' favor on all state law claims. On December 9, 1985, the district court granted Phillips' motion for prejudgment interest. We are informed that the judgment on the state law claims has been paid.

Lynch appealed.[4] On appeal, Merrill Lynch contends that the Federal Arbitration Act (Arbitration Act), 9 U.S.C. §§ 1-14 (1982), requires enforcement of the parties' arbitration agreement, and that the 1934 Act does not create an exception to this requirement.

II. DISCUSSION.

The centerpiece provision of the Federal Arbitration Act provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. In recent years, the Supreme

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[4] An order denying a motion to compel arbitration is appealable under 28 U.S.C. § 1292(a)(1) (1982) "as an interlocutory decision refusing an injunction in an action requesting legal relief." Surman v. Merrill Lynch, Pierce, Fenner & Smith, 733 F.2d 59, 61 (8th Cir. 1984).

Court has stressed that this provision, and the Arbitration Act as a whole, reflects a strong federal policy favoring the enforcement of arbitration agreements.[5] The Court has indicated that arbitration agreements should be liberally construed, and that any doubt as to the arbitrability of an issue should be resolved in favor of arbitration. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 105 S.Ct. 3346, 3353-54 (1985); Dean Witter Reynolds, Inc. v. Byrd, 105 S.Ct. 1238, 1242-43 (1985);

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[5] In Dean Witter Reynolds Inc. v. Byrd, 105 S.Ct. 1238, 1242-43 (1985), the Supreme Court concluded that "[t]he preeminent concern of Congress in passing the [Arbitration] Act was to enforce private agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate***." Furthermore, the Court explained that the Arbitration Act was designed to overcome the judiciary's long standing hostility toward agreements to arbitrate. Id. at 1241-43, and n.6.

Southland Corp. v. Keating, 465 U.S. 1, 10-16 (1984); Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24-25 (1983).

In Wilko v. Swan, 346 U.S. 427 (1953), however, the Supreme Court held that a predispute arbitration agreement unenforceable with regard to claims arising under section 12(2) of the 1933 Act. The Court reasoned that a predispute arbitration agreement is void under section 14 of the 1933 Act because it constitutes a stipulation binding the securities customer to waive compliance with a provision of the Act.[6] The

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[6] Section 14 of the Securities Act of 1933, 15 U.S.C. § 77n (1982), provides:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

provision referred to is the aggrieved party's right to select the judicial forum under section 22(a) of the 1933 Act.[7]

The Court deemed section 22(a) "the kind of 'provision' that cannot be waived" under section 14 by viewing it in conjunction with the substantive right afforded a securities customer in section 12(2). The Court observed that section 12(2) "create[s] a special right to recover for misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter." Wilko v. Swan, supra, 346 U.S.

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[7] Section 22(a) of the 1933 Act, 15 U.S.C. §77v(a)(1982), provides an aggrieved securities customer certain jurisdictional, venue, and service of process advantages, including the right to bring suit "in any court of competent jurisdiction-federal or state-and removal from a state court is prohibited." Wilko v. Swan, supra, 346 U.S. at 431.

at 431. It expressed concern that the "effectiveness" of this special right would be "lessened in arbitration as compared to judicial proceedings." Id. at 435. The Court, therefore, concluded that Congress must have intended section 14 to preclude the waiver of a section 22(a) judicial remedy for the section 12(2) right. Id. at 437. In short, the Wilko Court decided that Congress, in enacting the 1933 Act, created an exception to the mandate of the Arbitration Act.

A number of courts of appeals have held that Wilko extends to claims arising under section 10(b) of the 1934 Act and Rule 10b-5. E.g., Miller v. Drexel Burnham, Inc., No. 85-5692 (11th Cir. June 17, 1986) (per curiam) (available June 20, 1986, on WESTLAW, CTA Database); McMahon v. Shearson/American Express, Inc., 788

F.2d 94, 98 (2d Cir. 1986); De Lancie v. Birr, Wilson & Co., 648 F.2d 1255, 1258-59 (9th Cir. 1981); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1030 (6th Cir. 1979); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823, 827-29 (10th Cir. 1978); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 833-35 (7th Cir. 1977); Sibley v. Tandy Corp., 543 F.2d 540, 543 n.3 (5th Cir. 1976), cert. denied, 434 U.S. 824 (1977); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 536 (3d Cir.), cert. denied, 429 U.S. 1010 (1976). Recent Supreme Court pronouncements indicate, however, that this remains an open question. Dean Witter Reynolds Inc. v. Byrd, supra, 105 S.Ct. at 1240 n.1; Id. at 1244 (White, J., concurring); Scherk v.

Alberto-Culver Co., 417 U.S. 506, 513-14(1974).[8]

In the present case, the district court concluded, relying on its

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[8] Since Byrd there has been considerable ferment in the federal district courts regarding the arbitrability of claims arising under section 10(b) and Rule 10b-5. Some courts, following Justice White's concurrence, have held such claims to be arbitrable. E.g. Schriner v. Bear, Stearns & Co., No. C-86-0683 (N.D. Cal. May 27, 1986) (available June 16, 1986 on WESTLAW, DCT Database); Steinberg v. Illinois Co., Inc., No. 85 C 7131 (N.D. Ill. May 15, 1986) (available June 16, 1986 on WESTLAW, DCT Database); Fisher v. Prudential-Bache Securities, Inc., Civ. No. Y-86-388 (D.Md. May 12, 1986) (available June 16, 1986, WESTLAW, DCT Database); Gerhardstein v. Shearson/American Express, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶92,512 (N.D. Ohio March 3, 1986); Rockoff v. Shearson Lehman/American Express, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶92,513 (S.D. Fla. Feb. 12, 1986); Frye v. Paine Webber Jackson & Curtis, [Current] Fed. Sec. L. Rep. (CCH) ¶92,516 (N.D. Tex. Dec. 26, 1985); Bob Ladd, Inc. v. Adcock, 633 F. Supp. 241 (E.D. Ark. 1986); Shotto v. Laub, 632 F. Supp. 516 (D.Md. 1986); Jope v. Bear Stearns & Co., 632 F. Supp. 140 (N.D. Cal. 1985); Sacks v. Dean Witter Reynolds Inc., 627 F. Supp. 377 (C.D. Cal. 1985); Prawer v. Dean Witter Reynolds,

interpretation of this court's opinion in Surman v. Merrill Lynch, Pierce, Fenner & Smith, 733 F.2d 59 (8th Cir. 1984), that Wilko is to be read broadly. Therefore, the district court denied Merrill Lynch's

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Inc., 626 F. Supp. 642 (D. Mass. 1985); West v. Drexel Burnham Lambert, Inc., 623 F. Supp. 26 (W.D. Wash. 1985); Houlihan v. Schmacker, 621 F. Supp. 48 (E.D. Mo. 1985); Peele v. Kidder, Peabody & Co., Inc., 620 F. Supp. 61 (W.D. Mo. 1985); Land v. Dean Witter Reynolds, Inc., 617 F. Supp. 52 (E.D. Va. 1985). Other courts have continued to conclude that Wilko applies to 1934 Act claims and therefore have held that such claims are not arbitrable. E.g. Shapiro v. Merrill Lynch & Co., [Current] Fed. Sec. L. Rep. (CCH) ¶92,504 (S.D. Ohio Feb. 25, 1986); Bustamante v. Rotan Mosle, Inc., 633 F. Supp. 303 (S.D. Tex. 1986); Blomquist v. Churchill, 633 F. Supp. 131 (D.S.C. 1985); Bale v. Dean Witter Reynolds, Inc., 627 F. Supp. 650 (D. Minn. 1986); Levendag v. Churchill, 623 F. Supp. 620 (D.S.C. 1985). See also Palmer, Arbitration of Securities Complaints, Nat'l L.J., Dec. 9, 1985, at 15, col. 1.

Merrill Lynch contended at oral argument that two-thirds of the federal district courts that have considered the issue have held that claims arising under section 10(b) and Rule 10b-5 are arbitrable.

motion to compel arbitration of Phillips' section 10(b) and Rule 10b-5 claims.[9]

On appeal, Merrill Lynch contends, relying on language in Byrd and Scherk, and on the strong federal policy favoring arbitrability, that Wilko does not apply to claims arising under section 10(b) and

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[9] Phillips contends that Merrill Lynch has waived any right to compel arbitration of claims arising under section 10(b) and Rule 10b-5 because of its delay in seeking arbitration and its active participation in this lawsuit. The district court concluded that Merrill Lynch's motion was timely in light of the recent Supreme Court decision in Dean Witter Reynolds Inc. v. Byrd, supra. We agree with the district court's conclusion under the circumstances present in this case. See Fogarty v. Piper, 781 F.2d 662, 663 (8th Cir. 1986); see also Fisher v. A.G. Becker Paribas, Inc., No. 85-3962 (9th Cir. June 6, 1986) (available June 16, 1986, on WESTLAW, CTA Database); Rush v. Oppenheimer & Co., 779 F.2d 885, 887 (2d Cir. 1985). We note that a court should resolve in favor of arbitration "any doubts concerning * * * an allegation of waiver, delay, or a like defense to arbitrability." Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24-25 (1983).

Rule 10b-5. Merrill Lynch argues that the Arbitration Act requires enforcement of its predispute arbitration agreement with Phillips, and that the 1934 Act does not cerate an exception to this requirement. We agree.[10]

In Scherk v. Alberto-Culver Co., supra, 417 U.S. at 513-14, the Supreme Court, without deciding the issue, questioned the applicability of Wilko to section 10(b) and Rule 10b-5 claims.[11]

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[10] The Securities Industry Association, as amicus curiae, urges us to reassess the vitality of Wilko itself. Of course, we reject their invitation as that type of review is not the function of the federal appellate courts.

[11] Justice Douglas, however, in a dissenting opinion joined by Justices Brennan, White an Marshall, reasoned that Wilko extends to 1934 Act claims. Scherk v. Alberto-Culver Co., supra, 417 U.S. at 524-34 (Douglas, J., dissenting).

Justice White's concurrence in Byrd suggests that he has changed his mind. Dean Witter Reynolds Inc. v. Byrd, supra, 105 S.Ct. at 1244-45 (White, J., concurring).

Last term, in Dean Witter Reynolds Inc. v. Byrd, supra, 105 S.Ct. at 1240 n.1, the Court briefly reviewed the arguments raised in Scherk, yet concluded that the issue was not properly before it. In a separate occurrence, however, Justice White compared the 1933 and 1934 Acts and concluded that the extension of Wilko's reasoning to 1934 Act claims "is a matter of substantial doubt." Dean Witter Reynolds Inc. v. Byrd, supra, 105 S.Ct. at 1244 (White, J., concurring).[12]

We observe that although the 1934 Act contains a non-waiver provision, section 29(a),[13] virtually identical to section 14

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[12] Justice White did agree with the majority that the issue of whether 1934 Act claims are arbitrable was not properly before the Court. Dean Witter Reynolds Inc. v. Byrd, supra, 105 S.Ct. at 1244 (White, J., concurring).

[13] Section 29(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78cc(a) (1982), provides:

of the 1933 Act, counterparts of the other two provisions relied on by the Wilko Court "are imperfect or absent altogether." Dean Witter Reynolds Inc. v. Byrd, supra, 105 S.Ct. at 1244 (White, J., concurring). The jurisdictional provision of the 1934 Act, section 27, 15 U.S.C. § 78aa (1982), is narrower than section 22(a) of the 1933 Act. Section 27 requires a plaintiff to bring his or her action exclusively in federal court, while section 22(a) allows suit in federal or state court and prevents removal from a state court. See supra note 7, at 5. As the Supreme Court noted, compared to section 22(a) of the 1933 Act, section 27

> Any condition, stipulation or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

of the 1934 Act "significantly restrict[s] the plaintiff's choice of forum." Scherk v. Alberto-Culver Co., supra, 417 U.S. at 514 (footnote omitted).

Moreover, a plaintiff's cause of action under section 10(b) and Rule 10b-5 differs in important respects from his or her cause of action under section 12(2). Berger v. Bishop Investment Corp., 695 F.2d 302, 308 (8th Cir. 1982). First, the section 10(b) and Rule 10b-5 private cause of action is implied rather than express. Herman & MacLean v. Huddleston, 459 U.S. 375, 380 & nn.9-10 (1983). Second, unlike in a section 12(2) action, the plaintiff in an action under section 10(b) and Rule 10b-5 bears the burden of proving scienter. Ernst & Ernst v. Hochfelder, 425 U.S. 190, 193 (1976); Harris v. Union

Electric Co., 787 F.2d 355, 362 (8th Cir. 1986).[14]

The Supreme Court's decision in Wilko rested, at least in part, on the "special" nature of the section 12(2) right, so described because it is expressly created by Congress and "differs substantially from the common-law action in that" a securities customer is not required to prove scienter to recover. Wilko v. Swan, supra, 346 U.S. at 431. As we have observed, the section 10(b) and Rule 10b-5 cause of action lacks both of these attributes.

Based on these differences between the 1933 and 1934 Acts, and on the strong

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[14] "Imposition of liability under Section 12(2) * * * requires no showing of scienter, but rather permits recovery upon proof of a negligent misstatement or omission." Berger v. Bishop Investment Corp., 695 F.2d 302, 308 (8th Cir. 1982); see also L. Loss, Fundamentals of Securities Regulation 1021-29 (1983).

federal policy favoring enforcement of arbitration agreements, we conclude that Wilko's holding and rationale does not extend to claims arising under section 10(b) of the 1934 Act and Rule 10b-5. The non-waiver provision of the 1934 Act, section 29(a), simply does not override the Arbitration Act in the same manner as section 14 of the 1933 Act when it is not buttressed by special rights and broad jurisdictional provisions similar to those founding the 1933 Act.[15] As Justice White stated, "Wilko's solicitude for the federal cause of action -- the 'special right' established by Congress, 346 U.S. at 431, 74 S.Ct. at 184 -- is not necessarily appropriate where the cause of action is judicially implied and not so

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[15] See Katsoris, The Arbitration of a Public Securities Dispute, 53 Fordham L. Rev. 279-301 (1984).

different from the common law action." Dean Witter Reynolds Inc. v. Byrd, supra, 105 S.Ct. at 1244 (White, J., concurring). We hold, then, that Congress has not evinced an intention to preclude the waiver of judicial remedies for the section 10(b) and Rule 10b-5 rights at issue here.[16] Therefore, we reverse the order of the district court and remand for

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[16] As support for its contention that 1934 Act claims are not arbitrable, Phillips argues that arbitration is less effective than adjudication in enforcing a plaintiff's rights under the 1934 Act. We believe that this argument, if it has any validity, is largely beside the point. Congress, through the Arbitration Act, as well as the Supreme Court have expressed increased approval for the use of arbitration rather than adjudication. See supra P. 4-5. The question here is whether Congress has created an exception to the mandate of the Arbitration Act for a plaintiff's judicially implied section 10(b) and Rule 10b-5 rights. We conclude that it has not.

See also Katsoris, supra note 15, at 283-91, 309-14 (discussing securities arbitration procedures).

further proceedings consistent with this opinion.[17]

The decision in Swink & Co. v. Hereth, 784 F.2d 866 (8th Cir. 1986),

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[17] Phillips raises two additional arguments which require only brief mention.

First, Phillips appears to argue that Securities and Exchange Commission (SEC) Regulation 15c-2-2, 17 C.F.R. § 240.15c2-2 (1985), and related SEC "interpretive releases" either bar enforcement of the arbitration agreement at issue here or indicate that Wilko extends to 1934 Act claims. We disagree. SEC Regulation 15c2-2 provides, in pertinent part:

> (a) It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the Federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer.

As Merrill Lynch points out, this regulation has no direct impact on the present case because it was adopted and promulgated after the contracts between Merrill Lynch and Phillips were executed. Furthermore, we conclude that in adopting Regulation 15c2-2 the SEC intended only to reflect what it believed to be a settled

lends support for our holding here. Swink suggests that the reach of Wilko should be contained, rather than expanded. The case concerned a dispute arising out of the issuance of municipal bonds, for which Swink & Company, Inc. and Hereth, Orr & Jones, Inc. were co-managing underwriters. This court held that the Wilko doctrine does not override the arbitration proceedings of the Municipal Securities

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principle of law (i.e. that predispute arbitration agreements are unenforceable under both the 1933 Act and the 1934 Act). As this opinion indicates, the SEC was mistaken.

Second, Phillips, relying on one ambiguous sentence in a House Conference Report, argues that in enacting the 1975 amendments to the federal securities laws, Congress ratified the application of Wilko to the 1934 Act. H.R.Rep. No. 94-229, 94th Cong. 1st Sess. 111 (1975), reprinted in part in 1975 U.S. Code Cong. & Ad. News 321, 342; Securities Acts Amendments of 1975, Pub.L.No. 94-29, 89 Stat. 97. We reject this argument. Cf. Hirschey v. F.E.R.C., 777 F.2d 1, 7-8 (D.C. Cir. 1985) (Scalia, J., concurring) (criticizing routine deference to the detail of congressional committee reports).

Rulemaking Board in disputes between municipal bond dealers and associated persons. Swink & Co. v. Hereth, supra 784 F.2d at 868; see also Halliburton & Associates, Inc. v. Henderson, Few & Co., 774 F.2d 441, 445 (11th Cir. 1985).

Recently, however, the Second Circuit, in the first post-Byrd appellate court decision to consider the issue, held that claims arising under section 10(b) and Rule 10b-5 are not arbitrable. McMahon v. Shearson/American Express, supra, 788 F.2d at 98. The court pointed to the similarity of the non-waiver provisions of the 1933 and 1934 Acts, as well as the strong public policy concerns inherent in the federal securities laws, as support for its decision. Id. at 98. The court acknowledged that Byrd and Scherk have cast doubt in this area, yet

concluded that it was bound by "clear judicial precedent in this Circuit" holding that Wilko's reasoning extends to 1934 Act claims. Id.[18]

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[18] In a very recent decision, the Eleventh Circuit, relying simply on pre-Byrd precedent within that Circuit, also concluded that 1934 Act claims are not arbitrable. Miller v. Drexel Burnham, Inc., No. 85-5692 (11th Cir. June 17, 1986) (per curiam) (available June 20, 1986, on WESTLAW, CTA Database). The only discussion of this issue in the court's brief per curiam opinion is as follows:

> [W]e must vacate that portion of the district court order which compels arbitration of the 1934 Act fraud claim. Under the rule of [Belke v. Merrill Lynch, Pierce, Fenner & Smith, 693 F.2d 1023, 1025-26 (11th Cir. 1982)], no claims based on the federal securities acts are arbitrable. Nothing in Dean Witter v. Byrd holds otherwise since the Supreme Court expressly declined to reach the arbitrability of 1934 Act claims. See Byrd, supra at 1240 n.1. Belke remains the law of this circuit***.

Id.

See also Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 785 F.2d 1274, 1275 n.1 (th Cir.

We are faced, however, with no analogous Eighth Circuit precedent. Despite Phillips' argument to the contrary, Surman v. Merrill Lynch, Pierce, Fenner & Smith, supra, is not an exception. In that case, we noted that "[l]ower federal courts have * * * held with consistency that Wilko applies * * * to claim arising under the Securities Exchange Act of 1934." Surman v. Merrill Lynch, Pierce, Fenner & Smith, supra, 733 F.2d at 61. In Surman, however, the question of whether section 10(b) and Rule 10b-5 claims are arbitrable was not before the Court because the appellants did not move to compel arbitration of their 1934 Act claims. Id. at 60. Thus, the remarks in Surman constitute merely observations

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1986) (post-Byrd decision observing in dicta that "this Court and many other lower courts consistently have extended Wilko's reasoning to the 1934 Act").

on the state of the law and are purely dicta. Today, however, the question is before us, and we hold that predispute arbitration agreements are enforceable with regard to claims arising under section 10(b) of the 1934 Act and Rule 10b-5.

III. CONCLUSION.

Accordingly, we reverse the order of the district court and remand for further proceedings consistent with this opinion.

With regard to the remand, we observe from written materials furnished us by the parties that an arbitration award has been issued on Phillips' state law claims. See supra note 3. The arbitration award may well bar further proceedings by Phillips on the basis of issue preclusion, full satisfaction of claims or for other

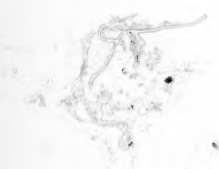
reasons. This court on the present record has noway of knowing whether Phillips may properly seek an additional or supplementary judgment on its federal securities claims. However, we presume that such issues which may arise from the effect of the state arbitration award on the federal claims will be considered on remand.

Finally, we observe that the federal appellate courts, in the absence of precedent in their own circuit, tend to rely on precedent in other circuits. Ordinarily, then, in deciding a case of this kind, we would defer to the opinion of another circuit, such as rendered by the Second Circuit in McMahon, and avoid creating a conflict within the circuits. We believe, however, that the Supreme Court's opinions in Scherk and Byrd have

invited a reexamination of the applicability of Wilko to claims arising under section 10(b) of the 1934 Act and Rule 10b-5. Because we are not bound by the precedents of other circuits, we are free to make a new assessment of this issue. We have made that assessment, and now create a conflict within the circuits. We assume the Supreme Court will eventually decide this question.

ROSS, Circuit Judge, dissenting.

I respectfully dissent. I cannot agree with the majority's holding that predispute arbitration agreements are enforceable with regard to claims arising under section 10(b) of the 1934 Act and Rule 10b-5. I adhere to the position that



Wilko v. Swan, 346 U.S. 427 (1953) applies and therefore precludes arbitration of such federal securities claims.

I take this position for three reasons. First, Wilko is still good law, and as the majority points out, eight circuits have extended it to 1934 Act claims. See ante p. 6. Moreover, neither Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) nor Dean Witter Reynolds, Inc. v. Byrd, 105 S.Ct. 1238 (1985) hold that Wilko would not apply in the context of a section 10(b) or Rule 10b-5 claim. Second, in my judgment the similarity of the nonwaiver provisions of the 1933 Act and the 1934 Act is of critical importance because I view section 14 of the 1933 Act to be the lynchpin of the Wilko analysis. Third, the policy considerations which

underlay Wilko, see 346 U.S. at 435-37, apply to the 1934 Act claims as well.

Because of the absence of clear precedent in this circuit,[19] I would give deference to the decision of the Second Circuit in McMahon v. Shearson/American Express, Inc., 788 F.2d 94, 98 (2d Cir. 1986) and the Eleventh Circuit in Miller v. Drexel Burnham, Inc., No. 85-5692 (11th Cir. June 17, 1986) (per curiam) (available June 20, 1986, on WESTLAW, CTA Database) and hold that claims under section 10(b) and Rule 10b-5 are not arbitrable. Accordingly, in the instant case I would affirm the order of the

---

[19] I do not view Swink & Co. v. Hereth, 784 F.2d 866 (8th Cir. 1986) as support for the majority's position because it is clearly distinguishable. Wilko was inapplicable in Swink because it involved a dispute between municipal bond dealers and associated persons subject to the arbitration proceedings of the Municipal Securities Rulemaking Board. Id. at 868.

district court denying the motion to compel arbitration of the claims arising under the 1934 Act.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS, EIGHTH CIRCUIT.

APPENDIX B

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

LOUIS L. PHILLIPS, et al., Plaintiffs, v. MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., et al., Defendants.	)	ORDER Civil No. 4-81-394

Before the court is defendants' motion for an order compelling arbitration of plaintiffs' claims arising under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, before the National Association of Securities Dealers. The motion, otherwise untimely, is occasioned by a recent Supreme Court decision. Defendants have submitted a memorandum and several cases in support; they rely on

Dean Witter Reynolds, Inc. v. Byrd, 53 U.S.L.W. 4222 (U.S. March 4, 1985), and subsequent decisions of a respected trial judge in the Middle District of Florida. Plaintiffs oppose the motion and have submitted a memorandum with attachments.

The court has carefully reviewed these submissions and the arguments advanced and concludes that the motion should be denied. It may be that the Supreme Court will further develop the law as suggested by Justice White's concurrence in Byrd and defendants' arguments, but in the meantime this court is bound to follow the Eighth Circuit Court of Appeals which has read Wilko v. Swan 346 U.S. 427 (1953), broadly. See Surman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 733 F.2d 59, 61-2 (1984).

Accordingly, based on the above and all the files, records, and proceedings herein,

IT IS HEREBY ORDERED that defendants' motion to compel arbitration of plaintiffs' claims arising under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 is denied.

Dated: April 11, 1985

DIANA E. MURPHY
UNITED STATES DISTRICT COURT

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT
JUDGMENT

No. 85-5156MN

Louis L. Phillips, et al. Appellees,	)	Appeal from the United States District Court for the District of Minnesota
-vs-	)	
Merrill Lynch Pierce Fenner, et al. Appellants.	)	

This appeal from the United States District Court was submitted on the record of the said district court, briefs of the parites and was argued by counsel.

Upon consideration of the premises, it is hereby adjudged and decreed that the judgment of the district court is reversed and remanded for further proceedings

consistent with the opinion of this Court.

July 9, 1986

Costs of briefs of appellants for recovery from appellees: $279.90

A true copy.

ATTEST: Robert D. St. Vrain
Clerk, U.S. COURT OF APPEALS,
Eighth Circuit
7/30/86

APPENDIX D
STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Arbitration Act

Section 2, 9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77 l (2):

> Any person who --
>
> * * *
>
> (2) offers or sells a security (whether or not exempted by the provisions of section 77C of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the

> mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,
>
> shall be liable to the person purchasing such security from him, who may sue either at law or inequity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Section 22(a), 15 U.S.C. 77v(a):

> The district courts of United States, the United States courts of any Territory, and the United States District Court for the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability of duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

Securities Exchange Act of 1934

Section 10, 15 U.S.C. § 78j(b):

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 27, 15 U.S.C. § 78aa:

> The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder.

> Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

Section 28(b), 15 U.S.C. § 78bb(b) (as amended in 1975):

> Nothing in this title shall be construed to modify existing law with regard to the binding effect (1) on any member of or participant in any self-regulatory organization of any action taken by the authorities of such organization to settle disputes between its members or participants, (2) on any municipal securities dealer or municipal securities broker of any action taken pursuant to a

procedure established by the Municipal Securities Rulemaking Board to settle disputes between municipal securities dealers and municipal securities brokers, or (3) of any action described in paragraph (1) or (2) on any person who has agreed to be bound thereby.

Section 29(a), 15 U.S.C. § 78 cc(a):

Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

Securities and Exchange Commission Regulation

Rule 10b-5, 17 C.F.R. § 240. 10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under

which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

in connection with the purchase or sale of any security.

Rule 15c2-2, 17 C.F.R. § 15c2-2(a):

(a) it shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the Federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for the customer.

Supreme Court, U.S.
FILED
NOV 6 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-578

IN THE

Supreme Court of the United States

LOUIS L. PHILLIPS AND L. L. PHILLIPS CHARITIES, INC.,

Petitioners,

vs.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., AND BEN M. SIRIANNI,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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November 6, 1986
**Counsel of Record*

1986—Northwest Printing Co., 3010 2nd St. No., Minneapolis, MN 55411—588-7506

QUESTION PRESENTED

Whether predispute arbitration agreements between a customer and a securities broker-dealer must be enforced as to claims arising under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240 10b-5 (1975).[1]

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[1]Purusant to Rule 28.1 of the Court, petitioner Merrill Lynch, Pierce, Fenner & Smith Incorporated states that it is a subsidiary of Merrill Lynch & Co., Inc., a publicly-held corporation whose shares are traded on, among others, the New York Stock Exchange. Subsidiaries of Merrill Lynch, Pierce, Fenner & Smith Incorporated that are not wholly-owned are: Merrill Lynch & Co., Canada, Ltd., Merrill Lynch Canada Incorporated/Incorporee, Merrill Lynch Life Agency Inc. (Ohio), Merrill Lynch Life Agency Inc. (Oklahoma), Merrill Lynch Life Agency Ltd. (Mississippi), Merrill Lynch-Nomura Management Company, Inc., and ML Life Agency Inc. Affiliates of Merrill Lynch, Pierce, Fenner & Smith Incorporated that are not wholly-owned by Merrill Lynch & Co., Inc. are ISU Companies, Inc., Merrill Lynch Bank & Trust Co., Merrill Lynch International Bank Limited, Mership Nominees Limited, Michigan Mart Properties Corp., Peaback Properties, Inc., Iran Financial Services Company, S.S.K., Merrill Lynch Asset Management Limited, Merrill Lynch (Australia) Pty Limited, Merrill Lynch, Pierce, Fenner & Smith (Brokers & Dealers) Limited, Merrill Lynch, Pierce, Fenner & Smith Limited, Royal Securities Corporation (Canada) Limited, Paluel-Marmont Merrill Lynch S.A., Merrill Lynch Philippines, Inc., Merrill Lynch, Pierce, Fenner & Smith Belge S.A., Merrill Lynch, Pierce, Fenner & Smith (Middle East) S.A.L., Merrill Lynch, Pierce, Fenner & Smith S.A., Merrill Lynch S.A.L., Merrill Lynch Pierce, Fenner & Smith (Taiwan) Ltd., Property Protection Associates & Co., Merrill Lynch — Sun Hung Kai (Overseas Securities) Company Limited, Sun Hung Kai - Merrill Lynch Commodities Limited, Merrill Lynch Representacoes Ltda., Merrill Lynch Realty Commercial Services of Georgia, Inc., Hammill-Quinlan, Inc., Merrill Lynch Realty North Bay Inc., Merrill Lynch Realty/North Los Angeles, Inc., Merrill Lynch Realty/Boomhower, Inc., Merrill Lynch Realty/Burnet, Inc., Merrill Lynch Realty Carll Burr, Inc., Merrill Lynch Realty/Cousins, Inc., Merrill Lynch Santa Barbara Inc., Merrill Lynch Realty/Jack Matthews, Inc., Merrill Lynch Realty/-Katella, Inc., Merrill Lynch Realty/MCK, Inc., Merrill Lynch Realty/-Richard Jowdy, Inc., Merrill Lynch Realty/Robedeaux, Inc., Merrill Lynch Realty/Tom Fannin Inc., ML/Rodgers & Cummings Insurance, Inc.

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Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* 2, 3, 4, 5, 6, 10, 11

Other:

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Fifth Report of the Securities Industry Conference on Arbitration, Statistical Report (April 1986) 9
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IN THE

Supreme Court of the United States

LOUIS L. PHILLIPS AND L. L. PHILLIPS CHARITIES, INC.,

Petitioners,

vs.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., AND BEN M. SIRIANNI,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

JOINT BRIEF FOR RESPONDENTS

Respondents Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") and Ben M. Sirianni ("Sirianni") respectfully respond to the petition for a writ of certiorari filed by petitioners Louis L. Phillips ("Phillips") and L. L. Phillips Charities Inc. ("Charities") seeking review of the decision of the United States Court of Appeals for the Eighth Circuit in this case.

Respondents believe that the Eighth Circuit correctly decided the question presented in the Petition. Recognizing, however, that on October 6, 1986, this Court granted a writ of certiorari in *Shearson/American Express, Inc. v. McMahon*, No. 86-46, on the question presented by the instant petition, respondents do not oppose a grant of the writ in

this case. If this Court grants the writ, the Eighth Circuit's decision should be affirmed.[2]

STATEMENT OF THE CASE

The factual background supplied in petitioners' Statement of the Case is incomplete. The facts are more fully set forth in the Eighth Circuit's Opinion. Pet. App. A-2 to A-7. Respondents submit the following specific facts that relate to the issues raised by the petition.

In 1978, petitioners Phillips and Charities opened accounts with respondent Merrill Lynch through respondent Sirianni, a broker in Merrill Lynch's office in Eau Claire, Wisconsin.[3] In their contracts, the parties voluntarily agreed to submit to arbitration any disputes arising from their relationship.

On July 6, 1981, Phillips filed a Complaint in the Federal District Court for the District of Minnesota. The Complaint alleged that various misrepresentations, omissions and unauthorized trading violated Section 10(b) of the Securities Exchange Act of 1934 ("the 1934 Act"), 15 U.S.C. § 78j(b), Section 12(2) of the Securities Act of 1933 ("the 1933 Act"), and various state-law duties, both statutory and common-law. Merrill Lynch answered the Complaint, denying the allegations and raising various affirmative defenses.

On June 5, 1984, in light of this Court's decision in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), Merrill

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[2]Respondent Merrill Lynch currently has pending before this Court a petition for a writ of certiorari from a decision of the Third Circuit that is in direct conflict with the Eighth Circuit's decision in the case at bar. *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 749 F.2d 1197 (3rd Cir. 1986), *petition for cert. pending*, No. 86-487.

[3]For convenience, this response will use "Phillips" to include both petitioners, and "Merrill Lynch" to indicate both respondents, except where otherwise indicated explicitly or by context.

Lynch moved the district court for an order compelling arbitration of the state securities-law and state common-law claims, and the district court granted the motion.[4] Pursuant to the district court's order and the parties' agreement, the state-law claims were arbitrated under the rules of the National Association of Securities Dealers ("the NASD") in May, 1985. The arbitrators rendered a decision awarding petitioners a total of $1,126,700.00. On Phillips' motion and Merrill Lynch's cross-motion, the district court confirmed the arbitration award and entered judgment thereon. Subsequently, the district Court also awarded prejudgment interest on the arbitration award for the period from the date of the award to entry of judgment. The judgment and interest have been paid in full.

On March 27,1985, following this Court's decision in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985), but prior to the arbitration on Phillips' state-law claims, Merrill Lynch moved the district court for an order compelling arbitration of the claim arising under Section 10(b) of the 1934 Act. On April 19, 1985, the district court denied this motion. Merrill Lynch then requested that Phillips conditionally submit the Section 10(b) claims to the same panel of arbitrators as was deciding the state-law claims, with the award to be enforceable as to Section 10(b) claims only if the district court's decision was reversed on appeal. Phillips declined this request. Meanwhile, Merrill Lynch

[4]The Minnesota Blue Sky Law contains a non-waiver provision similar to that contained in Section 14 of the 1933 Act, 15 U.S.C. § 77n and Section 27 of the 1934 Act, 15 U.S.C. § 78aa. Minn. Stat. 80A.23 subd. 10 (1982). Prior to *Southland*, the Minnesota Supreme Court had held that predispute arbitration agreements were unenforceable as to claims arising under Minn. Stat. § 80A. *Kiehne v. Purdy*, 309 N.W.2d 60 (Minn. 1981). In light of *Southland*, and subsequent to the district court's decision in the case at bar, the Minnesota Supreme Court expressly overruled *Kiehne. Fairview Cemetery Association v. Eckberg*, 385 N.W.2d 812, 817-18 (Minn. 1986).

had appealed the district court's refusal to compel arbitration of the 1934 Act claims. The Eighth Circuit heard argument on December 11, 1985, and handed down its decision on July 9, 1986, reversing the court below. In remanding, the Eighth Circuit noted that the arbitration award on the state-law claims in the interim may preclude further recovery by petitioners, but it left examination of that matter to the district court on remand. By stipulation of the parties, the district court has taken no further action, pending this Court's decision on the instant petition.

RESPONSE TO THE PETITION

Respondents again stress their belief that the Eighth Circuit decided this question correctly. Nevertheless, because this Court has already granted a similar writ in *Shearson/American Express, Inc. v. McMahon*, No. 86-46, and because the question presented in this case is one of national importance, respondents do not oppose the petition and ask this Court to affirm the Eighth Circuit's decision.

I

THE EIGHTH CIRCUIT IS THE ONLY APPELLATE COURT THAT HAS CORRECTLY APPLIED THIS COURT'S PRECEDENT.

In the proceeding below, the Eighth Circuit held that predispute arbitration agreements are enforceable as to claims arising under Section 10(b) of the 1934 Act. In explaining its holding, the Eighth Circuit openly acknowledged that its decision conflicted with recent decisions of the Second[5] and Eleventh[6] Circuits; subsequent to the

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[5]*McMahon v. Shearson/American Express, Inc.*, 788 F. 2d 94 (2d Cir. 1986), *cert. granted*, No. 86-46 (Oct. 6, 1986); see also *Kidder Peabody & Co. v. Intre Sport, Ltd.*, No. 86-40.

[6]*Miller v. Drexel Burnham Lambert, Inc.*, 791 F. 2d 850 (11th Cir. 1986).

Eighth Circuit's decision, the Third, Fifth, and Ninth Circuits have come into conflict with the Eighth Circuit's holding.[7] In *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. at 215 n.1, this Court noted that the enforceability of predispute arbitration agreements in this context is an open question. The Eighth Circuit is the one appellate court to have answered that question by implementing the views set forth in Justice White's concurrence. *Id.* at 224-225.

The Eighth Circuit began with the central assumption, repeatedly and emphatically upheld by this Court, that the Federal Arbitration Act mandates enforcement of arbitration agreements. Pet. App. at A-7 to A-9; *see also Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. at 218, 220-21. The Eighth Circuit then observed that this Court had held in *Wilko* that the 1933 Act had created an implied exception to the Arbitration Act. The Eighth Circuit noted that its own task was to determine whether the 1934 Act had implicitly created such an exception.

The Eighth Circuit then examined the arguments that had led this Court in *Wilko* to find an implicit partial repeal of the Arbitration Act. The *Wilko* Court had noted the broad jurisdictional provisions of the 1933 Act; the Eighth Circuit noted that the 1934 Act had more limited provisions. The *Wilko* Court had viewed section 12(2) as a "special right" significantly different from the common law; the Eighth Circuit noted that the section 10(b) right is no different from the common-law fraud law in any relevant respect and that it is an implied right of action, not a "special" right. The

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[7]Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 749 F.2d 1197 (3d Cir. 1986), *petition for cert. pending*, No. 86-487; King v. Drexel Burnham Lambert, Inc., 796 F.2d 59 (5th Cir. 1986), *petition for cert. pending*, No. 86-282; Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520 (9th Cir. 1986), *petition for cert. pending*, No. 86-321.

Eighth Circuit therefore concluded that "Congress has not evinced an intention to preclude the waiver of judicial remedies" for section 10(b) claims. Pet. App. at A-22.

In derogation of the Eighth Circuit's opinion, petitioners offer two arguments from post-enactment history, which they incorrectly state that the Eighth Circuit "disregarded." *First,* they argue that the Eighth Circuit's decision conflicted with an SEC regulation purporting to ban predispute arbitration agreements as deceptive practices. The Eighth Circuit correctly noted that the regulation is based on a faulty premise—that such agreements are unenforceable as to claims arising under the 1934 Act. Having rejected the premise, the Eighth Circuit found the conclusion unsupported.

Second, petitioners argue that certain remarks in a 1975 congressional committee report amount to congressional ratification of *Wilko* and its extension to the 1934 Act. The Eighth Circuit rejected this argument, citing Justice Scalia's opinion in *Hirschey v. F.E.R.C.*, 777 F.2d 1, 7-8 (D.C. Cir. 1985) (Scalia, J., concurring). More recently, the Eleventh Circuit, although disagreeing with the Eighth Circuit's ultimate conclusion, noted that the very remarks quoted by petitioners are completly ambiguous and do not support the argument here. *Wolfe v. E.F. Hutton & Co.*, 800 F.2d 1032, 1037 (11th Cir. 1986) (en banc). The Eleventh Circuit also noted the further argument, raised by petitioners here, that in adopting the 1975 amendments to the 1934 Act, Congress failed to explicitly state that predispute arbitration agreements are enforceable. But even the Eleventh Circuit recognized that "an inference from congressional silence is of somewhat limited value . . ." *Id.* at 1038.

In short, the Eighth Circiut began with decisional framework that this Court used in *Wilko*, and it determined that

neither the factors determinative in *Wilko* nor the additional arguments that petitioners raised support an implied repeal of the Federal Arbitration Act. This decision correctly applies the *Wilko* holding and the dictum in *Byrd* and *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 513-14 (1974). Respondents urge this Court to affirm the Eighth Circuit's decision.

II

THE *PHILLIPS* RECORD PRESENTS A UNIQUE OPPORTUNITY BECAUSE IT CONTAINS THE PROCEEDINGS OF A COMPLETED ARBITRATION.

A

The *Phillips* records contains what no other case now pending before this Court contains: the transcript of a completed arbitration. Indeed, the existence of an arbitration transcript is itself rare because, consistent with arbitration's interest in inexpensive and streamlined proceedings, transcripts are not usually made.[8]

In *Wilko v. Swan*, 346 U.S. 427, 435-36 (1953), this Court cited the less formal procedures of arbitration as a significant reason in justifying its decision not to enforce the Federal Arbitration Act in the context of a claim arising under Section 12(2) of the 1933 Act. In pointed contrast, Justice Frankfurter, joined in his dissent by Justice Minton,

[8]The NASD Arbitration Rules provide that no record of the proceedings need be kept, but if a party requests that a record be kept, then a verbatim record *must* be kept. NASD Code of Arbitration Procedure § 37, NASD Manual (CCH) ¶ 3737 (1984). The costs of transcription are paid by the party or parties requesting the record. *Id.* In this case, Merrill Lynch requested that a record be made; Merrill Lynch bore the full cost of transcription. The transcript consists of six volumes, one for each day of the proceedings. This transcript is cited hereinafter as "Arb. Tr."

noted that "[t]here is nothing in the record before us, nor in the facts of which we can take judicial notice, to indicate that the arbitral system as practiced in the City of New York, and as enforceable under the supervisory authority of the District Court for the Southern District of New York, would not afford the plaintiff the rights to which he is entitled." *Id.* at 439.

Justice Frankfurter's remarks are especially appropos to this case, for Phillips received ample protection—and vindication—of his substantive rights. Pursuant to the agreement between Phillips and Merrill Lynch, the parties' dispute was submitted to arbitration before the NASD.[9] The NASD arbitration director nominated a five-member panel of arbitrators. The NASD rules permit each party at least one peremptory challenge and an unlimited number of challenges for cause,[10] although in this case neither party used any challenges since all of the arbitrators were acceptable to the parties. As required by the NASD Rules, a majority of the panel were "public" representatives; only two members of the panel were from the securities industry.[11] The chair-

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[9]The agreements provide that Phillips would have five days after receipt of a demand for arbitration to designate the exchange before which he wished the arbitration to be conducted, although he did not have to agree to submit to arbitration in order to exercise this right of designation. In the event that Phillips did not so designate within five days, Merrill Lynch was permitted to designate. Phillips did not designate a forum within the permitted time, so Merrill Lynch designated NASD.

[10]NASD Code of Arbitration Procedures § 22, NASD Manual (CCR) ¶ 3722 (1984). A copy of the NASD Code of Arbitration Procedures has been made available to the Court in the Supplemental Lodging of Amici Curiae in Support of a Petition for a Writ of Certiorari in *Shearson/American Express, Inc. v. McMahon*, No. 86-46. The Supplemental Lodging also contains copies of the American Stock Exchange, Inc. Arbitration Rules and the New York Stock Exchange. Inc. Arbitration Rules. The Amicus brief filed with the Supplemental Lodging contains the Uniform Code of Arbitration as Appendix A.

[11]*Id.* ¶ 19, NASD Manual (CCH) ¶ 3719(a). Under the terms of this rule, a public customer (but not the broker-dealer) is permitted to waive this requirement and insist that the panel contain at least a majority from the securities industry.

man of the panel was a former judge on the Illinois Court of Appeals, who has stepped down from that court at the end of 1984. Another member was a professor of law at DePaul University in Chicago. Two other members were lawyers in private practice, and one of them actually had been a floor trader at the Chicago Board Options Exchange, Inc. The fifth member was a director of compliance for a broker-dealer.

The arbitration hearing lasted six days. Prior to the hearing, the parties had exchanged exhibits and had agreed upon a schedule for witnesses. The panel accepted briefiing on various legal issues, including, for example, the choice-of-law issue. The panel disposed of several preliminary matters, much as an Article III court would do, and then heard opening statements. There followed several days of testimony, and the parties were permitted to make objections; in at least one instance, the panel permitted a voir dire of a witness prior to determining whether to admit the testimony. Arb. Tr. at 520-24. Both parties were permitted to and did present expert testimony. At the end of the hearing, each side presented closing arguments. The hearing was then concluded. In the words of petitioners' counsel, the NASD hearing had given petitioners "an opportunity to be heard, a good opportunity and equal, too." Arb. Tr. at 1187.

Ultimately petitioners prevailed. They did not receive the full damages that they claimed, but they did receive a sizeable award of $1.2 million. If making a transcript of arbitration proceedings is atypical, the award in petitioners' favor certainly is not. For the five-year period 1980-85, 52% of the public-customer cases actually decided in the public customer's favor.[12] For 1985 alone, the figure was

[12]Fifth Report of the Securities Industry Conference on Arbitration, Statistical Report (April 1986) (Exhibit A). This report does not include statistics for the American Arbitration Association.

55%.[13] In other words, the facts amply support the theory: predispute arbitration agreements do not deprive customers of any substantive rights—they merely provide a forum for their vindication.

Thus, arbitration does not disadvantage securities plaintiffs as a class; they retain their substantive protections against wrongdoing by broker-dealers. Similarly, the much larger class of securities *customers*, of which securities *plaintiffs* are just a small subclass,[14] retain the deterrent effect of these substantive protections in their own transactions.

Respondents believe that the Arbitration Act is mandatory and that the 1934 Act in no way implicitly limited that mandate. Therefore, the procedures that a securities plaintiff obtains in arbitration should be of little consequence. Nevertheless, the *Wilko* Court considered the procedures important in construing the 1933 Act, and this Court may wish to examine the procedures available in contemporary arbitration. To the extent that the type of procedures available to securities plaintiffs in 1986 may be significant to this Court, the *Phillips* record presents the ideal opportunity to examine those procedures not only in theory but in practice as well.

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[13] *Id.*

[14] The securities industry executes millions of transactions for its customers every year, but the number of legal actions brought against broker-dealers is relatively small. For example in fiscal year 1985, there were 3,266 newly filed actions in the federal courts under both securities and commodities statutes. *See* Annual Report of the Director of the Administrative Office of the United States Courts, Table 19 (1985) (statistics for 7/84-6/85). This statistic does not include 1933 Act claims filed in state court under that statute's concurrent-jurisdiction provisions, but it *does* include all 1934 Act claims, which must be filed exclusively in federal court.

B

Examination of the *Phillips* record might be useful to the Court in another way. If predispute arbitration agreements are enforceable in this context, then in the future, 1934 Act claims and state-law claims will be submitted and heard together. If on the other hand, 1934 Act claims cannot be arbitrated pursuant to predispute agreements, then there will necessarily be two procedings when a plaintiff asserts both state and federal claims. This possibility in turn raises the problem of the preclusive effect, if any, to be accorded to an arbitration award on state-law claims in subsequent proceedings on related federal claims. Indeed, in its opinion remanding this matter to the district court, the Eighth Circuit noted that "[t]he arbitration award may well bar further proceedings by Phillips on the basis of issue preclusion, full satisfaction of claims or for other reasons."[15] Pet. App. at A-28 to A-29.

In *Byrd* this Court observed that the potential for preclusion problems was not a reason for failing to enforce the Arbitration Act. *Dean Witter Reynolds Inc. v. Byrd,* 470 U.S. at 221-223. Here the Court faces a different question: in construing a federal statute and reconciling potentially conflicting Federal statutes, may the Court consider the practical and public policy consequences of its decision? Clearly the Court may do so. *See e.g., Walton v. Cotton,* 60

[15]By stipulation of the parties, the district court has taken no action pending this Court's decision on the petition. See *supra* at p. 4. Preclusion quite probably will bar further proceedings on the 1934 Act claims if this Court affirms the Eighth Circuit's decision, for the abitrators decided essentially the same issues as would be raised in proceedings on the 1934 Act claims. Even if this Court reverses the Eighth Circuit, preclusion might still come into play, either because the petitioners proceeded to arbitration of their state-law claims knowing of the potential preclusion problems, or because they sought and obtained judicial enforcement of the abitration award.

U.S. (19 How.) 355, 358 (1857). In this instance, the Court might rightly consider two public policy considerations: the burgeoning federal caseload, and the difficulties entailed in devising new preclusion rules. These two problems will be exacerbated if this Court refuses to enforce predispute agreements, and so before reaching such a decision, the Court might wish to consider the proceedings that might be given preclusive effect.

This Court could largely eliminate the problem of preclusive effect by holding predispute arbitration agreements enforceable.[16] In reaching this highly practical result, the Court may find it useful to examine the *Phillips* arbitration and the type of proceeding in which securities claims would be resolved.

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[16]The issue would still exist as to 1933 Act claims, which under *Wilko* cannot be abitrated pursuant to predispute agreements. There will also be a temporary problem as to those cases in which arbitration has occurred prior to this Court's resolution of the enforceability question.

CONCLUSION

For the reasons stated in this Brief, if the Petition for Writ of Certiorari in this case should be granted, the Eighth Circuit's decision should be affirmed.

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Respectfully submitted,

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